

# Memorandum

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**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Debra Figone  
City Manager

**SUBJECT: CITY MANAGER'S  
GENERAL FUND STRUCTURAL  
DEFICIT TASK FORCE REPORT**

**DATE:** January 7, 2008

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## INFORMATION ONLY

### **PURPOSE**

Attached for your review is the *City of San José - Development of Strategies to Address the City's General Fund Structural Budget Deficit* report as prepared by the City's consultant Management Partners, Inc. This report provides a series of recommended strategies that could be used as a starting point in the process to eliminate the General Fund structural budget deficit within a three year period and is the culmination of the efforts of the City Manager's General Fund Structural Deficit Task Force over the past three months.

### **BACKGROUND**

In the 2007-2008 Mayor's March Budget Message, the City Manager was directed to work with the Mayor in support of his Budget Shortfall Advisory Group that is tasked with developing a three-year financial strategic plan for addressing the City's General Fund structural deficit. To support this effort, I formed a technical team, the City Manager's General Fund Structural Deficit Task Force, to define the General Fund structural deficit and develop, with full stakeholder input, both short-term and long-term strategies that could be adopted by the City Council to eliminate the deficit within three years. To assist in this effort, the City contracted with Management Partners, a consulting firm specializing in local government problem solving.

### **PROBLEM**

The General Fund Structural Deficit is currently estimated at \$137 million over a four year period. Of this amount, \$75 million is the projected General Fund shortfall to support existing programs as identified in the November 2007 Preliminary 2009-2013 General Fund Forecast. The remaining components of the General Fund deficit address areas currently not funded, including the annual unmet/deferred infrastructure and maintenance needs (\$40.2 million, excluding the one-time backlog of over \$500 million in the General Fund) and the General Fund portion of the unfunded liability associated with post-employment health benefits (\$21.6 million) as shown in the following table.

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**PROBLEM** (Cont'd.)**General Fund Structural Budget Deficit  
(\$ in Millions)**

	<b>2008- 2009</b>	<b>2009- 2010</b>	<b>2010- 2011</b>	<b>2011- 2012</b>	<b>Total</b>
Projected General Fund Shortfall (Nov. 2007 Forecast)	\$24.8	\$41.8	\$2.4	\$6.4	\$75.4
Unmet/Deferred Infrastructure & Maintenance Needs*	\$39.7		\$3.2	(\$2.7)	\$40.2
GASB 43/45 (General Fund Retirement Benefits)**	\$21.6				\$21.6
<b>Total</b>	<b>\$86.1</b>	<b>\$41.8</b>	<b>\$5.6</b>	<b>\$3.7</b>	<b>\$137.2</b>

\* Assumes one-time needs of over \$500 million in the General Fund (\$900 million all funds) are addressed.

\*\* City's 50% of General Fund portion of remaining annual requirement for full pre-funding (\$57.4 million); current annual City/employee contribution of \$43.9 million.

To understand the City's current financial position and to put the structural deficit into perspective, it is important to have an understanding of the economic conditions that impacted the City over the last decade and the budget actions that have already been necessary to address the resulting budget shortfalls. During the economic boom experienced during the late 1990s and early into this decade, the City experienced extremely strong revenue growth and had to remain competitive in a job market where there was the lowest unemployment rate ever recorded in a large California city. When the dot-com bubble burst in late 2001, the San José region lost nearly 200,000 jobs, the unemployment rate soared above 8%, and the City revenues fell dramatically. Over the last six years, the City eliminated over 450 positions and closed cumulative General Fund budget shortfalls totaling over \$300 million. This is the backdrop to the current efforts to eliminate the remaining General Fund structural deficit while continuing to address the service demands of a growing city.

**STRATEGY DEVELOPMENT PROCESS**

Over the past three months, Management Partners and the City Manager's General Fund Structural Deficit Task Force have endeavored to solicit input and feedback on potential strategies to address the structural deficit from a broad variety of stakeholders, including the City's Senior Staff, the City Labor Alliance, employees, and community and business groups (including City boards and commissions). In addition, an electronic survey was conducted between October 26, 2007 and November 9, 2007. This survey generated 2,033 responses from City employees and 656 responses from the community.

Through these various outreach efforts, over 200 strategies to address the City's structural deficit were suggested. To identify the highest priority strategies to pursue, the following criteria were developed as an initial screening device for each identified strategy:

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### **STRATEGY DEVELOPMENT PROCESS** (Cont'd.)

#### **Qualification Criteria**

- 1) Benchmarking shows San José either below market (revenues) or above market (expenditures);
- 2) Strategy is being used in a best practice jurisdiction or another peer jurisdiction;
- 3) Prior work by Budget Office or other City department has made a convincing argument for change; and
- 4) Practice is out of alignment with current City objectives or planning.

#### **Disqualification Criteria**

- 1) Strategy can not effectively be implemented in the three-year time frame;
- 2) Strategy would not reduce the deficit or, if it did, would have greater longer run costs (e.g. deferred maintenance);
- 3) Strategy is not consistent with the current City Council three year goals; and/or
- 4) Strategy would have a limited impact and can not be logically combined with other similar strategies.

Slightly over 100 of the suggested strategies were qualified for some level of further analysis. It should be noted that many of the strategies that did not qualify may be ideas worthy of further consideration, but cannot be implemented in the three-year period (e.g., economic development strategies).

Through this screening process, the strategies that are being brought forward for City Council consideration in the attached report are broken down into four categories: Revenue Strategies; Service Delivery Model Changes; Expenditure Controls and Shifts; and Service Reductions. The potential impact of the strategies on the General Fund deficit are primarily displayed in dollar ranges as many of the strategies could be implemented in various ways. It is important to note that all strategies and their associated fiscal impacts would need to be refined based on further analysis prior to implementation. Also, many of the identified strategies would be subject to voter approval or the meet and confer process with the City's bargaining units. It should be noted that a combination of these strategies would be necessary to eliminate the structural deficit in order to preserve core City services and minimize the financial impact on the community.

### **BUDGET PRINCIPLES TO AVOID FUTURE STRUCTURAL DEFICITS**

At the Mayor's Budget Shortfall Advisory Group meeting that was held on November 15, 2007, the Mayor asked for potential budget principles to be developed that could be considered for adoption by the City Council to help prevent the City from getting into a structural deficit position again. Twelve budget principles have been included in the report for consideration. Although the City has extensive budget policies and one year budget balancing principles, these over-arching principles were developed to ensure that future budget actions do not erode the progress that is anticipated to be completed over the next three years to eliminate the General Fund deficit.

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**NEXT STEPS**

The strategies and principles contained in the attached report are intended to serve as a resource for the Mayor's Budget Shortfall Advisory Group, which will begin their review of this information on January 10, 2008. The Mayor's Budget Shortfall Advisory Group is scheduled to bring forward its recommendations on eliminating the structural deficit within a three-year period to the City Council on February 12, 2008. It is expected that the report generated from this advisory group and the subsequent City Council feedback will provide the framework to move forward over the next three years to eliminate the structural deficit. Community input and integration into the City's budget process will continue to be important components of this process.

As part of this multi-year effort to eliminate the structural deficit, it is important to keep in mind that the \$24.8 million General Fund shortfall projected for 2008-2009 will need to be addressed immediately as part of the upcoming budget process. Given the magnitude of reductions and other budget balancing solutions that have already been implemented over the past six years, the development of the 2008-2009 budget will be extremely challenging. To guide the initial planning efforts, the organization has recently been given City Service Area (CSA) reduction targets (1.5% for the Public Safety CSA and 11.5% for all other CSAs) and has been directed to identify proposals to meet the shortfall in the context of considering the long-term vision for the City, to propose new program or service additions only by the redeployment of existing resources, and to focus on ongoing rather than one-time budget solutions. The proposals developed as part of this direction will serve as an important component of the service reduction strategy for addressing the structural deficit. While this process is difficult, it also presents an opportunity to rethink the services that are delivered and the methods to deliver those services. Consistent with the annual budget process, I will be releasing the 2008-2009 Proposed Operating Budget on May 1, 2008 that will bring forward General Fund budget balancing recommendations for City Council consideration for budget adoption in June.

If you have any questions regarding the contents of this report or the budget process, please feel free to contact me or Larry Lisenbee and/or Jennifer Maguire of the Budget Office at 535-8144.

Debra Figone  
City Manager

Attachment